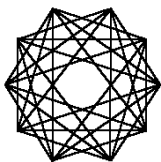


**USAID**  
**Social**  
**Sector**  
**Reform**  
**Program**  
**in Ukraine**

**POLICY**  
**REPORT No. 30**  
**JANUARY 1999**



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# **UKRAINE'S SUCCESSFUL PROGRAM OF SOCIAL SECTOR REFORM**

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## PREFACE

**I**t is widely believed that systemic reform in Ukraine is almost impossible. The Government of Ukraine, it is feared, is neither committed to nor capable of implementing systemic reform. This view is mistaken. Since 1995, the GOU has successfully restructured social assistance and social insurance systems that are far more radical than those achieved by other members of the former Soviet Union. These reforms, in turn, have allowed widespread pricing reforms that have restructured consumer spending, created budget savings of over \$1 billion annually, and laid the foundation for the emergence of market-based relations.

The missteps and delays in programs of privatization, fiscal reform, and the rule of law have received much broader press coverage than the successes in social sector reform. The speed and success of social sector reforms would have been impossible without a comprehensive program of international technical support, led and coordinated by the United States Agency for International Development. This success should guide the design and implementation of USAID's strategy for future technical assistance to the GOU to continue the process of reform.

In January 1995, USAID began assisting the GOU in the restructuring of social sector programs. The project began by concentrating on the design and nationwide implementation of the housing subsidy program and the accompanying increases in monthly payments by families for housing and utility payments. It was then slowly expanded, based on demonstrated successes, to include: 1) the creation of a full-scale welfare program to assist low-income families; 2) the reform of state and non-state pension systems in Ukraine; 3) the development of collateral administrative systems including auditing, and monthly reporting; and 4) the development of new methodologies for establishing the poverty level.<sup>1</sup> This report describes the achievements of this program and the reasons for this success.

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<sup>1</sup> The original work was conducted under contract to PADCO. After October 1, 1996, the social sector reform project was continued under a contract between USAID and The Bancroft Group, and, after December 1, 1996, additional work was supported by a contract between USAID and Chemonics. PADCO was the principal subcontractor on both contracts. On February 1, 1998, the program was continued under a direct contract with PADCO.

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## 1. UKRAINE'S ECONOMIC TRANSITION REQUIRES SOCIAL SECTOR REFORM

Building market economies from the socialist rubble of the former Soviet Union is a monumentally difficult task. With no legal framework to create and protect private property and human rights, no tradition of democratic decision making, no understanding of how markets work, no road map of the best path to economic recovery, and split by deep political and social divisions, newly independent states have suffered devastating economic and social collapses.

While new economic opportunities have been created in gray economies for some, for most, the most visible and immediate consequence of transition has been poverty. As price controls were lifted, food, housing, energy, and other basic goods and services were no longer affordable to people dependent on government benefits and fixed wages. Inflation, ignited by attempts to cover budget deficits by printing money, eliminated savings -- leaving the elderly with no cushion against harsh new economic realities. The abrupt end of the arms race placed millions of manufacturing employees on indefinite lay-off or in part-time employment. The absence of a financial sector to redirect investment funds stifled the growth of new opportunities. Endemic corruption, punitive taxes, intrusive regulations, and xenophobia reduced to a trickle the level of foreign investment, which had supported transition in Central Europe. And worsening budget deficits froze pensions and other benefits far below subsistence levels.

Socialist economies are ill equipped to cope with poverty. The very reforms necessary to create a private, market-oriented economy eroded the foundations of socialist social protection systems. Basic goods and services had been guaranteed by the very price controls that had to be dismantled to allow market incentives to work. Enterprises that had provided their employees with health services, kindergartens, and even vacation sanatoria could no longer afford to pay wages. Contributions to state pensions, to unemployment systems, and to disability funds fell precipitously. There were no programs intended to help poor people because acute poverty was new.

The newly poor resent the "reforms" they believe are destroying their living standards and turn to political parties calling for a "return to the normalcy" of socialism. To sustain economic reform, therefore, it is necessary to restructure social insurance programs (old-age pensions, unemployment and health benefits) and to create, from whole cloth, social assistance systems to guarantee subsistence levels of goods and services to the poor.

Since reform of the social sector necessarily involves eliminating entitlements that had benefited the entire population, it faces formidable political problems. Middle-income families must learn to live without childcare assistance and to pay full prices for basic goods and services. Hundreds of categories of workers must give up privileges that bestow early retirement of pension supplements. Cheap housing, low-cost electricity, easy access to recreation and health facilities, and the thousands of other entitlements to which individuals and families had become accustomed must be done away with or devalued.

With assistance from USAID, however, Ukraine has moved quickly to design and implement new social assistance programs that have allowed it to increase prices for housing and utilities. And it has embarked on systemic reforms in old-age pensions. The following sections describe what Ukraine has already achieved, why USAID's assistance was vital to this success, and how USAID can help sustain Ukraine's progress in the future.

But social sector reform -- like economic transition -- is a long process. The table on the following page outlines what could reasonably be achieved in Ukraine with a six-year program of USAID-sponsored technical support for social sector reform. The table describes USAID sponsored activities, the resulting changes in Ukraine's social sector and the economic reforms that are enabled by these changes in the social sector.



<div> <div> <b>USAID SUPPORT FOR SOCIAL SECTOR REFORM LEADING TO . . .</b> </div> <div> <b>STRUCTURAL REFORMS BY GOU IN SOCIAL SECTOR PROGRAMS, WHICH LEADS TO . . .</b> </div> <div> <b>BROAD ECONOMIC REFORMS SUPPORTING EVOLUTION OF MARKETS</b> </div> </div>			
1	<ul style="list-style-type: none"> <li>Assistance in design of targeted assistance programs</li> <li>Assistance in implementation of targeted assistance programs</li> </ul>	<ul style="list-style-type: none"> <li>Creation of new means-tested benefits for low-income families</li> </ul>	<ul style="list-style-type: none"> <li>Reduction of subsidies from State Budget to agricultural and housing sectors support low prices</li> <li>Stabilization of prices through reduction of monetary emissions</li> <li>Decontrol of prices of food, housing and utilities</li> </ul>
2	<ul style="list-style-type: none"> <li>Assistance with automation of administration of social protection programs</li> </ul>	<ul style="list-style-type: none"> <li>Introduction of auditing and financial reporting</li> <li>Introduction of MIS systems</li> <li>Reduction of administrative expenditures</li> <li>Consolidation of local administrative staff and offices</li> </ul>	<ul style="list-style-type: none"> <li>Further reduction of budget deficit</li> <li>Incentives for privatization of housing and communal services</li> <li>Improvement in local government accountability and administrative efficiency</li> </ul>
3	<ul style="list-style-type: none"> <li>Assistance with improvement of social and economic statistics</li> </ul>	<ul style="list-style-type: none"> <li>Improvement of targeting of social assistance benefits</li> <li>Reduction or elimination of untargeted social entitlements</li> <li>Stronger political agreement on issues of poverty</li> </ul>	<ul style="list-style-type: none"> <li>Further reductions in budget deficits</li> <li>Better measurement of economic performance</li> </ul>
4	<ul style="list-style-type: none"> <li>Assistance with creation of personified reporting and record keeping by Pension Fund and other social protection programs</li> <li>Assistance with restructuring of administration of State Pension System</li> </ul>	<ul style="list-style-type: none"> <li>Improvement in compliance in payroll tax payments</li> <li>Reductions in administrative cost of state pension system</li> <li>Reduction in fraud and abuse in calculation of pension benefits</li> <li>Increases in state pension benefits</li> <li>Reduction in pension arrears</li> </ul>	<ul style="list-style-type: none"> <li>Reduction in budget expenditures to cover state pension deficits</li> <li>Reduction in gray economy</li> <li>Strengthening of rule of law and reduction of corruption in administrative systems</li> <li>Elimination of workbooks and employer wage certifications, and enhanced labor market mobility</li> <li>Ability to average wages over a longer time period in the calculation of pension benefits</li> </ul>
5	<ul style="list-style-type: none"> <li>Assistance in the design and implementation of mandatory funding of part of state pension system</li> <li>Assistance in creation of safe private pension funds through design and implementation of regulatory structure and administrative systems</li> </ul>	<ul style="list-style-type: none"> <li>Increases in state pensions</li> <li>Improvement in quality of life of elderly and invalids</li> <li>Decentralization of investment decisions</li> <li>Reduction in payroll tax rate</li> <li>Diversification of pension risk</li> <li>Reduction in pension system pressures due to aging population</li> </ul>	<ul style="list-style-type: none"> <li>Development of private capital markets</li> <li>Increase in long-term private capital investment</li> <li>Evolution of mature capital market institutions</li> <li>Improved capacity of governments to borrow in international capital markets</li> <li>Change in citizen attitude from expecting government to provide everything to making individual decisions about their own future</li> </ul>

## AN OVERVIEW OF UKRAINE'S SUCCESS

**S**ocial sector reform in Ukraine has been a successful collaboration between the Government and international donors – led and coordinated by the United States Agency for International Development. It has been characterized by its emphasis on supporting economic reforms and on creating systems that are fiscally sustainable. The table beginning on the following page lists the major USAID sponsored activities during the period 1995 – 1999 as well as the tangible outcomes achieved.

By any measure, Ukraine's achievements are impressive: despite severe economic adversity and deepening economic problems, the GOU managed to enact enabling legislation for the housing subsidy program within two months of raising tariffs for housing and communal services. It opened 750 offices within three months of enacting the decree, and enrolled one million families within five months of opening offices. It has also raised tariffs for housing and utilities from 4% of costs to 80% of costs within two years, reduced government subsidies for the housing sector by over \$1 billion annually, created audit and reporting systems, and has held program costs in tight control. At the same time, the automation of program administration has allowed administrative costs of the targeted assistance program to be kept below 1.5% of the value of targeted benefits distributed to low income families.

One way of measuring the extent to which the social sector reform program has met the needs of the Government of Ukraine is the extent to which the fiscally strapped GOU has committed its own resources to implementing the reforms supported by USAID. The major commitments by the GOU in the past three and one-half years include:

- The GOU created 756 Housing Subsidy Offices and approved and paid for the 7,000 full time staff for those offices;
- Oblast and local administrations purchased more than 600 computers and related equipment (printers, UPSs) from local resources to equip housing subsidy offices to match the 400 computers provided by USAID;
- The GOU created a department in the Ministry of Labor and Social Policy with a staff of 8 to manage the housing subsidy program;

- The Ministry of Labor and Social Policy has created an e-mail system using government lines to all oblasts and is now extending this system to all local offices in 609 raions and 145 oblast subordinated cities and towns, using the Ministry of Internal Security system;
- The Ministry of Finance has approved and financed the creation of an Office of the Actuary within the Pension Fund with 5 staff to support the development of the actuarial model of the pension system;
- The GOU has enacted over 50 Presidential and Cabinet decrees needed to implement recommendations of the USAID/PADCO social sector reform project;
- The GOU has implemented (and paid for) large scale pilot projects to develop new systems – including a nationwide audit of over 100,000 applicants for housing subsidies, the development of new reporting systems for the Pension Fund, and the linking of pension offices with housing subsidy offices; and
- The Ministry of Labor and Social Policy has created a permanent monthly training program in Ministry facilities, which every month trains 25 local social protection staff in the use of new computer software.
- The Pension Fund has dedicated 30 million USD over the next three years to the creation of a personified records for the state pension system, created a separate personification office in Kyiv, and assigned a personification coordinator in each raion office

The success of the program of social sector reform has helped the USAID Mission in Kyiv meet four of its nine strategic objectives for its technical assistance programs in Ukraine. These are:

- Increased soundness of fiscal policies and fiscal management practices. Social protection programs account for nearly two-thirds of the Consolidated State Budget – therefore, the improvement in efficiency and effectiveness of these programs coupled with the elimination in wasteful subsidies for the housing and communal services sector is exerting a large impact on Ukraine's overall fiscal soundness.
- More effective, responsible, and accountable local governments. Two thirds of all spending for social protection programs is made by local

governments – out of the local portion of the Consolidated State Budget. The MIS and reporting systems developed over the past three years and the increased accountability embodied in them is improving local government practices.

- Improved sustainability of social benefits and services. Sustainability depends on tight targeting, cutting general entitlements, and on the creation of accurate fiscal forecasting models of the annual costs of social protection pro-

grams. The actuarial model of the pension system and the monthly reporting system developed for the housing subsidy program allow accurate forecasting of program costs.

- Reduced human suffering and mitigating the impacts of economic and social crises. Targeted social assistance programs, and social insurance programs have the greatest effect on reducing human suffering during the period of economic transition

<b>1995: Focus on Development of Targeted Housing Subsidy Program</b>	
<i>USAID Project Activities</i>	<i>Tangible Outcomes</i>
<ul style="list-style-type: none"> <li>• Created legal and administrative basis for Housing Subsidy Program -- drafting 7 normative acts adopted by Cabinet</li> <li>• Supported implementation of utility pricing reform – beginning the process of raising payments from 4% to 80% of costs</li> <li>• Observational tour of 18 cabinet members to Nizhny Novgorod to view operation of USAID supported housing assistance program in Russia.</li> <li>• Office procedures manual provided for all local housing subsidy offices</li> <li>• Managed training of 6,000 local office staff and established office operating procedures for housing subsidy program</li> <li>• Educated public on need for targeted assistance and utility rate increases through numerous TV and radio advertisements and dozens of press conferences</li> <li>• USAID installs 40 computers in pilot housing subsidy offices</li> <li>• Developed first version of NASH DIM caseload management software, installed in 200 offices, and trained 200 staff in its use.</li> <li>• Conducted 3 observational tours in USA of 40 senior Ukrainian officials from MLSP and from oblasts to view social assistance systems in operation in Washington DC and Madison, WI.</li> </ul>	<p><b>February:</b> Cabinet Decree No. 89 issued, creating the housing subsidy program.</p> <p>Housing and utility payments raised to 20% of costs</p> <p><b>March:</b> Cabinet of Ministers sets up department in Ministry of Labor and Social Policy to manage housing subsidy program</p> <p><b>April:</b> Although the Cabinet was dismissed by Supreme Rada for failing to protect population from impacts of price reforms, two attempts by Supreme Rada to roll back tariff increases were defeated as a result of information package on housing subsidy program distributed to all deputies</p> <p><b>May 3:</b> 750 housing subsidy offices are opened nationwide and begin receiving applications</p> <p><b>June:</b> Housing and utility payments raised to 30% of costs</p> <p><b>August:</b> Housing subsidy program extended to cover rural families' purchases of liquid gas and heating fuel</p> <p><b>Sept:</b> Housing and utility payments raised to 40% of costs</p> <p><b>October:</b> One millionth family receives housing subsidy</p> <p><i>Net budget savings for 1995 (in today's prices): 100 million Hrn</i></p>

<b>1996: Focus on Automation of Housing Subsidy Program and Development of Information and Reporting Systems</b>	
<i>USAID Project Activities</i>	<i>Tangible Outcomes</i>
<ul style="list-style-type: none"> <li>Seven additional normative acts drafted and issued by Cabinet to improve housing subsidy program</li> <li>Automated many local housing subsidy offices: <ul style="list-style-type: none"> <li>Installed 355 USAID-purchased computers</li> <li>Revised/installed NASH DIM caseload management and reporting software in 300 Offices</li> <li>Fully automated applicant processing and report preparation</li> <li>Trained 600 local staff in use of computers and software</li> </ul> </li> <li>Linked social protection offices and housing subsidy offices to allow automatic enrollment in program of pensioners and invalids</li> <li>Designed and tested auditing system of applicants for means-tested assistance</li> </ul>	<p><b>January:</b> Housing and utility payments raised to 60% of costs</p> <p><b>February:</b> Two millionth family receives housing subsidy</p> <p><b>August:</b> Housing and utility payments raised to 80% of costs</p> <p><b>July:</b> Ministry of Labor and Social Policy introduces monthly training sessions for housing subsidy local office staff</p> <p><b>October:</b> Three millionth family receives housing subsidy</p> <p><b>November:</b> Nationwide pilot audit of a sample of housing subsidy program applicants and offices conducted</p> <p><i>USAID/PADCO caseload software used in 300 local offices</i></p> <p><i>Local governments purchase 300 computers</i></p> <p><i>Net budget savings for 1996: 900 million Hrn</i></p>
<b>1997: Focus on: 1) Improvement of Housing Subsidy Program, 2) Design of Pension Reforms, and 3) Design of Guaranteed Minimum Income Program</b>	
<i>USAID Project Activities</i>	<i>Tangible Outcomes</i>
<ul style="list-style-type: none"> <li>Eleven major normative acts drafted and issued by Cabinet</li> <li>Installed Local Area Networks in 130 oblast and local housing subsidy offices</li> <li>Designed and implemented monitoring system of caseload and financial flows</li> <li>Designed and tested individualized pension reporting system</li> <li>Created Electronic Library of all normative acts, automatically updated, which is installed in all oblasts and in large local offices,</li> <li>Created e-mail based communications system linking all oblasts and many local offices to the Ministry of labor and Social Policy</li> <li>Created reporting system for State Committee for Statistics on utility indebtedness among families and local budgets</li> <li>Developed automated system for linking housing subsidy offices, local social protection offices, and State Tax Administration</li> <li>Developed plan for poverty monitoring system</li> <li>Designed first stage of Targeted Family Assistance Program</li> <li>Designed software for nationwide auditing</li> </ul>	<p><b>March:</b> Automated system of monthly reporting created from 32 pilot housing subsidy offices to show financial accounts and caseloads</p> <p><b>June:</b> Ministry begins to use e-mail to issue instructions, rules and regulations to oblasts and local offices</p> <p><b>September:</b> Two-week seminar held on social statistics and reporting systems for GosKomStat and oblast officials</p> <p><b>October:</b> Nationwide program to audit incomes of applicants begun</p> <p><b>October:</b> Supreme Rada approves World Bank loan of \$2.6 million to computerize all housing subsidy offices</p> <p><b>November:</b> Pilot program to test computerized payments systems for ZHEKs completed in 5 test sites</p> <p><b>November:</b> State Committee for Statistics introduces new monthly reporting system on housing subsidies and utility indebtedness</p> <p><b>November:</b> Caseload of housing subsidy program reaches maximum, stabilizes, and slowly declines in subsequent months</p> <p><b>December:</b> Completion of pilot program to create personified pension reporting system</p> <p><i>Local governments purchased 500 computers for housing subsidy offices</i></p> <p><i>Net budget savings for 1997: 2.4 billion Hrn</i></p>

**1998 Focus on: 1) Refinement of Targeted housing subsidy program, 2) Reform of Pension System, 3) Measurement of Poverty, 4) Creation of Guaranteed Minimum Income Program**

<i>USAID Project Activities</i>	<i>Tangible Outcomes</i>
<ul style="list-style-type: none"> <li>• Drafted new law on family assistance (in collaboration with MLSP and TACIS)</li> <li>• Designed and installed caseload management software for childcare assistance program</li> <li>• Designed and installed monthly reporting system for Ministry of Labor and Social Policy for social protection programs</li> <li>• Designed software and training program for oblast and local office management information systems</li> <li>• Developed actuarial model for state pension system, using World Bank Prost model, and Excel model</li> <li>• Approval for creation of the Office of the Actuary. Design of mathematics exam</li> <li>• Analysis of poverty assessment methodologies with recommendations for reform</li> <li>• Begin assistance to Pension Fund to create nationwide personified reporting system</li> <li>• Begin assistance to MLSP to install and utilize 1,000 computers purchased with World Bank credit</li> <li>• Develop software for caseload management of targeted family assistance program</li> <li>• Seminars held on pension reform issues</li> </ul>	<p><b>February:</b> Ministry successfully conducts first-ever competitive tender to purchase of 1,000 computers for housing subsidy offices</p> <p><b>March:</b> Mikolaiv Oblast transfers childcare assistance program to local social protection offices from enterprises</p> <p><b>July:</b> Ministry of Labor and Social Policy submitted draft law on Targeted Family Assistance to Cabinet of Ministers</p> <p><b>July:</b> Actuarial analysis of current and proposed pension system completed</p> <p><b>August:</b> Housing and utility payments raised to cover 100% but reversed by Supreme Rada</p> <p><b>August:</b> Family share of monthly utility payments for housing subsidies raised from 15% to 20%</p> <p><b>September:</b> Seminar conducted on Non-State Pension Systems for 26 senior officials</p> <p><b>October:</b> Pension Fund begins Office of the Actuary</p> <p><b>October:</b> Pilot personified reporting programs begun in L'viv oblasts</p> <p><b>November:</b> Ukrainian officials receive training in use of World Bank Prost model, and attend World Bank seminar on pension reform in the former Soviet Union</p> <p><b>December:</b> Design and instructions for new Quarterly Survey of Family Income and Expenditures completed</p> <p><b>December:</b> Cabinet approves new targeted assistance program</p> <p><i>Local governments purchase 300 additional computers and Ministry purchases 1,000 computers with World Bank loan in first closed bid competitive tender</i></p> <p><i>Projected net budget savings for 1998: 2.6 billion Hrn</i></p>

**1999: Focus on: 1) Complete the Automation of Housing Subsidy Program; 2) Implementation of Reform of Pension System, 3) Setting the Poverty Level, 4) Implementation of Unified Targeted Assistance Program**

<i>USAID Project Activities</i>	<i>Projected Outcomes</i>
<ul style="list-style-type: none"> <li>• Implement reforms in delivery of pension benefits:</li> <li>• Assist Pension Fund and Ministry to develop legislative strategy for reform of state and non-state pension systems</li> <li>• Train staff in Office of the Actuary</li> <li>• Develop personified database of all pensioners</li> <li>• Assist with nationwide implementation of ARM-R, software for employer reporting of personified data on all Ukrainian workers to the Pension Fund</li> <li>• Complete development of actuarial model of state pension system</li> <li>• Design regulatory system for non-state pension funds</li> <li>• Study tours and seminars on pension reform issues</li> <li>• Assist Pension Fund and Ministry to implement pilot non-state pension programs</li> <li>• Restructure nationwide system of offices providing targeted family assistance</li> <li>• Develop and install new integrated software for managing all programs of targeted assistance</li> <li>• Reform system for establishing poverty level and improve national family income statistics</li> <li>• Reduce privileges and entitlement programs</li> <li>• Continued support for automation of housing subsidy program</li> </ul>	<p>1,088 computers installed in housing subsidy offices</p> <p>Train 500 local office housing subsidy staff in use of computers</p> <p>Train 500 Ministry local office staff in use of computers for targeted assistance program</p> <p>Completion of new family income and expenditure report based on new quarterly survey by State Committee for Statistics</p> <p>Integration of housing subsidy offices and Ministry Offices of Social Assistance into single social assistance system</p> <p>700,000 families enrolled in targeted family assistance program – caseload of housing subsidy program reduced by 10% and costs reduced by 20%</p> <p>Transfer responsibility for calculating pensions from Ministry to Pension Fund</p> <p>Personified reports prepared by 25% of all enterprises in Ukraine by end of year</p> <p>Passage by Supreme Rada of amended laws on State and Non-State Pension Systems</p> <p>Begin to eliminate workbooks</p> <p><i>Projected Net budget savings for 1999: 1.0 billion Hrn for targeted social assistance programs, 1 billion Hrn from reducing privileges, and 2.0 billion + for pension system reforms</i></p>

### 3. WHY SOCIAL SECTOR REFORM NEEDS TECHNICAL ASSISTANCE

Recognizing the need to reform Ukraine's social protection systems, USAID began in 1994 providing technical assistance to the Government of Ukraine. The initial goal was to support reform of the chronically weak state pension system. In January 1995, USAID extended its assistance to help create a targeted assistance program to protect families from the impacts of rising prices for housing and utilities.

Implementing social sector reform, however, faced daunting obstacles. Few Ukrainians understood how social protection systems operate in market economies. Neither the public at large nor government officials responsible for implementing new social protection systems understood the extent or the nature of the problems ailing Ukrainian government programs, nor what options they had for improving the worsening situation. Most believed that Ukraine's problems were temporary and would disappear as soon as the economy recovered. In fact, economic recovery was impossible without economic reforms -- and economic reforms were politically impossible without restructuring social protection systems.

Unfortunately, the basic building blocks for a new social protection system were missing. Reliable data on the economic situation confronting Ukraine's population was almost wholly missing -- while inaccurate and misleading information abounded. The administrative infrastructure to manage social protection programs was also absent. Paradoxically, in the centralized social system, much of the responsibility for managing social protection programs had been delegated to state enterprises. For those few programs for which government agencies were responsible, management was primitive. "Caseloads" were handled at the local level, with only summary information -- or misinformation -- shared with higher levels of government or with other government agencies. There were no databases of program recipients or personal incomes, and few staff with any understanding of how to create the missing information. Decision-makers in Kyiv moved forward by anecdote and tradition. Computers, copiers, calcula-

tors, and communications systems were absent. Most offices lacked even stationary, bookshelves, and pens. Management systems had never been developed and neither financial flows nor program effectiveness were audited. Office procedures were learned by rote; offices lacked training programs, manuals, and even copies of enabling legislation.

The Soviet system of central control had also effectively eliminated individual initiative from the enormous bureaucratic pyramid that ran social protection programs. Officials at all levels emphasized performing tasks according to the book rather than to achieve results. This is a bureaucratic failing in all nations -- but much worse in the former Soviet Union. Bureaucrats faced sanctions if their paperwork was not in order -- heavy sanctions since nearly 40% of annual take home pay was in the form of quarterly or annual bonuses that depended on paper flow not results.<sup>2</sup> With no timely and accurate data about what was happening in the field, managers had no idea if programs were working. Innovation was more likely to result in punishment than reward.

Soviet systems for administering social protection programs ignored the needs of "customers." Of course, the media was in no position to explore and publicize bureaucratic abuses. When the housing subsidy offices were about to open, and PADCO staff expressed concern over the potential for long lines of applicants if utility prices were raised sharply, a senior Cabinet official observed that "the Ukrainian people are used to standing in line . . . one more line won't hurt them." In the end, the price increase was delayed by one month, and long lines were minimized.

Technical assistance would not have succeeded had it been limited to expert policy advice.

<sup>2</sup> One of the housing subsidy offices set up through the USAID/PADCO social sector restructuring project (see below), eliminated much of the paperwork when it was computerized. It maintained records -- backed up daily -- in its computer network. Needless to say, Ministry officials initially penalized the office for not having the required piles of hard copy littering its closets.

However willingly GOU counterparts listened to foreign experts about how to design reforms, they lacked the institutional infrastructure and staffing skills to implement even modest changes.<sup>3</sup> In fact, GOU officials became adept at listening to the advice of foreign experts, cordially agreeing to implement whatever was recommended, only to abandon activity as soon as the expert left. Lacking even rudimentary office equipment, and unable to pay for long distance telephone calls, officials could do little without assistance, no matter how strongly they supported proposals for reform.

Technical assistance, therefore, must be comprehensive – not only helping identify general directions for reforms, but also figuring out how to implement them. Technical assistance succeeds, therefore, only if it supports implementation. But most foreign experts do not enjoy the messy business of implementation -- it requires a level of knowledge that they prefer to leave to research assistants.

How comprehensive donor assistance encourages systemic reform is illustrated by the speed with which the housing subsidy program was implemented. This contrasts which much slower progress on pension reform during 1996 and 1997, when assistance focused on policy recommendations rather than on a full-scale program of technical assistance. These contrasting stories are related in the following two sections of this summary. The final section describes what needs to be done to support continued progress in the social sphere.

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<sup>3</sup> Even in well-run departments, it could take between two or three months for copies of new laws, decrees, and instructions to trickle down into the field offices where they were needed.

## 4. SUCCESS THROUGH COMPREHENSIVE TECHNICAL ASSISTANCE: A) THE HOUSING SUBSIDY PROGRAM

### 4.1: BACKGROUND

In 1994, Ukraine faced an acute financial crisis. After independence in August 1991, it had resisted making reforms in its obsolete and increasingly indebted economy. It had run up huge debts by continuing to pipe in most of its oil and gas from Russia and Turkmenistan at vastly increased prices. The budget deficit had reached 10 percent of GDP and the policy of printing money rather than cutting spending had caused runaway inflation.

With the winter heating season imminent, Ukraine turned to the International Monetary Fund to borrow enough to keep Russia from turning off the energy supplies. But the IMF demanded reforms as the condition for granting credit. On October 20, 1994, an accord between the IMF and Ukraine was announced. Under the agreement, Ukraine received a standby credit of up to \$1.7 billion, to be paid in four tranches if Ukraine met a series of conditions – known by the IMF neologism as “conditionalities.” For its part, the Government of Ukraine promised price deregulation (including rapid increases in the prices for housing and communal services) as well as accelerated privatization, reduced deficits, monetary discipline, and other changes. The Government scheduled a series of utility price hikes that would lead to monthly housing payments that would cover 80 percent of cost within less than one year. Although the schedule proved overambitious -- 80 percent cost recovery was actually attained reached in August 1996 rather than on the target date of September 1995 -- Ukraine eventually managed increases faster than other members of the former Soviet Union did.

The Government and the IMF were notably silent on whether Ukrainian families could afford the scheduled increases and what could be done for those that could not. The IMF's unofficial position was that because there was a lot of hidden income in Ukraine, most families could probably pay. But families without hidden incomes would

soon face monthly bills requiring them to pay 60 percent or more of their income on housing and communal services. Many pensioners, invalids, and single mothers could barely buy enough food, even at subsidized prices. The typical three-member family lucky enough to live in a three-room apartment (about 500 square feet), would have had to pay in excess of \$30 per month -- nearly half their average monthly income at the time. Single pensioners in big apartments would have been asked for monthly payments in excess of their monthly state pension just to keep the lights on and the gas stove alight.

The Cabinet of Ministers issued a hasty patchwork of decrees intended to help families cope with higher prices: state enterprises were ordered to give out wage supplements and the state promised pension supplements. But enterprises and national ministries lacked money and administrative structures to honor these promises. Three months later, when the housing subsidy program replaced these measures, no money had been paid under these programs to assist families.

### 4.2: BEGINNING THE HOUSING SUBSIDY PROGRAM

When monthly payments were raised to 20 percent of costs -- retroactively effective to October 1, 1994 -- a cadre of socialist and communist deputies from the Supreme Rada called on the population not to pay the increases. The Cabinet hastily abolished all penalties on paying late. Arrears soared. But the issue of how families could pay for housing became mute by Christmas 1994. Currency emissions issued each fall to pay for the diminishing harvests and to prop up state enterprises had rekindled inflation. The new high prices for housing shrank in real terms until households were paying no more than before price reform. The same Cabinet Decree that raised prices for water, heat, and electricity had also freed prices of many foodstuffs. Food prices were free to follow inflation while tariffs for hous-

ing and communal services could be adjusted only by Cabinet decree.

Ukraine received the first tranche of its IMF loan and used most of it to pay Russia enough to ensure adequate fuel for the winter. But it was no nearer solving its deepening financial and economic problems. With the IMF ensuring its conditionalities were obeyed, First Vice Prime Minister V. M. Pynzenyk asked USAID to help design a way to target assistance to low-income families that would allow housing sector price reforms to continue. In January 1995, USAID contracted with PADCO, a private consulting company that had been working in Ukraine for two years on housing and communal service pricing issues, to provide this help. The goal of the new project was to develop a means-tested social assistance program – the first in Ukraine -- for poor families to protect them from the full impacts of rising monthly payments for housing and utilities.

Within a few weeks, on February 4, 1995, a new Cabinet Decree was drafted and issued, creating a housing subsidy program to assist low-income families. Less than three months later, on May 3, 750 offices were opened throughout Ukraine to receive applications from families. The housing subsidy is not a cash benefit. It is a discount on monthly payments equal to the difference between 20% of income (then, only 15% of income) and actual payments (within the standardized amount of space for the family size). Housing maintenance organizations and utilities were to be paid directly by local governments to compensate for these subsidies. Families are eligible, whether tenants or homeowners. Rural families facing annual payments for liquid gas and solid fuel for heating (within the standardized amount of space for the family size) in excess of 20% of annual family income can also apply.

The first subsidies were granted within a few days of the offices being opened. Before offices opened, the USAID/PADCO project had designed, printed, and distributed more than a million copies each of the six standard forms needed by local offices. By the end of 1996, one and a half years after subsidy offices first opened their doors,

about 4 million of Ukraine's 17.1 million families were receiving assistance monthly to help pay monthly utility payments or to assist in purchasing annual heating fuel supplies.

Since that date, the number of families receiving assistance has slowly declined, as incomes reported by applicants grow (despite the absence of measurable economic recovery). Single parents and single pensioners make up a disproportionately large share of families participating in the program. By December 1997, the average per family subsidy was about 30 Hrn/month – equivalent to about 26% of the average family income of participating families. For single pensioners, the average housing subsidy was equivalent to an increase of pension benefits of 65%.

#### **4.3: THE ACHIEVEMENTS OF THE HOUSING SUBSIDY PROGRAM**

The housing subsidy program has become widely accepted by the public and by elected leaders as an essential part of the Government's social assistance policy. In 1998, the program was in the process of being reshaped from a program providing housing subsidies into the foundation of Ukraine's new, means-tested, social assistance program that will provide both cash and in-kind benefits for poor families.

The program succeeded in supporting Ukraine's ambitious program of increasing the prices for housing and utilities. The Government has been able to increase the share paid by families from 4 percent in late 1994 to nearly 100% today (lack of accounting reform in the housing and communal services sector prevents an accurate assessment of the true rate of cost recovery). As a result, net savings to all levels of government in 1997 from increasing housing and utility payments, even after paying for targeted housing subsidies to low-income families, were 2.4 billion Hrn. (or \$1.3 billion). In two and one half years, net savings to the budget have totaled more than \$2 billion. The projected savings for 1998 are for a further savings of over \$1 billion.

## 5. SUCCESS THROUGH COMPREHENSIVE TECHNICAL ASSISTANCE: B) THE CASE OF PENSION REFORM

### 5.1: BACKGROUND

The state pension system collapsed during 1993 and 1994, when hyperinflation reduced the real value of pension benefits by 70 percent. Invalids and the elderly quickly became the new poor. Their financial hardship was sadly exacerbated because inflation had also wiped out most of the value of the savings accounts held by many pensioners as insurance against economic adversity in old age.<sup>4</sup>

As more and more enterprises encountered financial difficulties, they became less and less regular in paying contributions to the Pension Fund. In 1996, the Government increased pensions for the first time in nearly two years. Predictably, pension arrears mounted. By mid-1998, arrears exceeded 2.5 billion Hrn – about 3 months of pensions. However, in some locations, pension payments were up to 8 months behind, and many payments were in-kind, rather than in cash.

Pension reform did not begin seriously until USAID provided comprehensive technical support to the Pension Fund and to the Ministry of Labor and Social Policy.

### 5.2 TALKS, TALKS, AND MORE TALKS

Because of the size and urgency of the pension crisis, international donors were quick to offer advice. Beginning in 1994, international donors began sending advisors to help the GOU develop a strategy for pension reform. These advisors worked with counterparts in the State Pension Fund, the Ministry of Labor and Social Policy, and the Ministry of Finance, and with trade unions. They organized round tables, seminars, and conferences to educate officials about how pension systems operated in other countries and attempted to agree on fiscally and politically feasible reforms.

<sup>4</sup> In 1994, the Government promised to compensate all those who had been holding savings with the state banks where they had lost their savings. However, the first repayments were not made until 1998, when compensation was paid only to the estates of those who had since died.

Donors wanted to reach a consensus on the shape of pension reforms before committing large-scale assistance. Discussions, for the most part, ranged over general issues – raising the pension age, improving the rate of collection of contributions, starting a mandatory accumulation system, and relating benefits more closely to work experience and past earnings.

Unfortunately, no concrete agreement was reached – for reasons that offer important lessons for the design of technical assistance strategies. In the first place, most Ukrainian counterparts understood neither the size nor the causes of the problem. The lack of understanding could not be remedied because few of the participants trusted the information distributed at meetings by foreign advisors. Neither the Pension Fund of Ukraine, the Ministry of Finance, nor the Ministry of Labor and Social Policy had built actuarial models to make projections. With no agreement on the facts, there could be no agreement about what to do.

In early 1997, TACIS, the World Bank, and the Harvard Institute for International Development all tried to build agreement around their own models. This failed because the models were built with little or no participation by staff from the Pension Fund or the Ministry. Projections were largely indecipherable to untrained Ukrainian counterparts and were often not even translated into Ukrainian (or Russian). Counterparts were expected to “trust” the models based on the foreign advisors’ superior expertise. Consequently, none of the draft pension reform laws submitted to the Supreme Rada in 1998 had been rigorously analyzed.

A second reason for the failure to reach agreement was the unwillingness of Ukrainian counterparts to consider reforms that would rearrange responsibilities among different agencies. The desire to defend turf can blind even the best-qualified bureaucrat to the merits of proposed reforms.

Third, even if Ukrainian officials were willing to agree to a reform proposal, they lacked the

knowledge and resources to design and implement them. Foreign advice about pension policy was, necessarily, offered at a fairly high level of abstraction. But translating general advice into specific implementation plans proved difficult for inexperienced counterparts. Departments responsible for administering different aspects of the pension system are, by western standards, tiny. There are only 120 staff in the Ministry of Labor and Social Policy head office in Kyiv managing all social protection programs – from childcare and housing subsidies to systems for calculating and distributing pensions and overseeing dozens of orphanages, old people's homes, and sanatoria.<sup>5</sup> The slow development of pension reform, therefore, was because, while many donors offered general advice, no one had offered a comprehensive program of technical assistance. Neither donors nor counterparts had a clear vision of what was needed to implement pension reform.

### 5.3 ENTER THE WORLD BANK

The situation changed in early 1997. The extent of the deterioration of the State Pension system became less easy to deny and the March 1998 elections for the Supreme Rada were looming closer and closer. The Harvard Institute for International Development had assisted Vice Prime Minister Victor Pynzenyk to prepare a series of draft reform bills addressing bankruptcy law, pension reform, tax reform, the elimination of privileges, and proposals to accelerate privatization of state-owned assets. This broad reform package was divided into bite-sized portions by the Supreme Rada, and picked apart, bill by bill. The reform program contained no implementation plans for the numerous recommendations offered. It attempted to do too much too quickly.

From the wreckage of the reform program, the Cabinet of Ministers created a Pension Reform Task Force in February. Its goal was to develop a pension reform package extensive enough to justify applying for a credit from the World Bank for between \$200 million and \$400 million USD. The money would be used to pay off pen-

sion arrears and finance systemic reforms in the State Pension system. The Task Force began intensive meetings in April 1997. At the end of June, however, discussions were suspended. The GOU rejected two "deal breaking" conditions set by World Bank experts: 1) to begin immediately raising the age at which people would be eligible to receive pensions; and 2) begin funding a portion of the state pension by diverting a part of current contributions into individual accounts. Throughout the Task Force's deliberations, there had been little concrete discussion about how the massive -- and growing -- deficit in the State Pension system would be covered.

### 5.4 USAID SUCCEEDS WITH A MORE PRAGMATIC APPROACH

Following the suspension of talks concerning the credit from the World Bank, and the rejection by the Task Force of a fully privatized pension system, Ukraine and USAID-contractor PADCO initiated a more pragmatic approach. Whatever changes were finally made in the state and in private pension systems, Ukraine needed to find ways to pay adequate pensions on time and to begin building the information infrastructure as the foundation for future pension reforms. In the summer of 1997, PADCO successfully developed and implemented a prototype software program in collaboration with the Pension Fund of Ukraine and the Ministry of Labor and Social Policy. The program allowed enterprises to prepare for the Pension Fund quarterly reports showing for each employee (identified by TIN number) how much salary had been paid and how much contribution was due to the Pension Fund for each individual. This project is referred to as "personification of the pension reporting system."

Under a new contract with USAID, beginning on February 1, 1998, PADCO brought in a new actuarial expert who began developing an actuarial model of the Ukrainian pension system in collaboration with the Ministry of Finance, the Ministry of Labor and Social Policy, and the Pension Fund of Ukraine. By August 1998, this model was being refined based on comments from technical staff from both collaborating agencies. In addition, at the project's recommendation, the Ministry of Finance had agreed to create, within the Pension Fund of Ukraine, an Office of the Actuary. This Office will be staffed by individuals with backgrounds in mathematical and computer

<sup>5</sup> A department in the Ministry with a staff of only 8 people (including two secretaries), for example, manages the entire housing subsidy program. The Department of Health and Human Services, in Washington DC, would have at least 300 staff, backed up by modern computer and communications systems, to run a comparable program.

activities and will be responsible for fiscal analysis of the current pension system and of proposed changes to the system. Responsibility for developing and maintaining the actuarial models would be transferred to this Office. This would create a permanent capacity in Ukraine to operate models that could actually project revenues and expenditures of the state system under alternative scenarios for reform. This capacity is needed for the Cabinet of Ministers to proceed through the complex and politically tense process of implementing pension reform.

At the same time, the Pension Fund asked for further help implementing the personification project – refining the software, developing a system for building personified databases within the pension fund, and training enterprises and Pension Fund staff in the use of the new system. The President and the Cabinet of Ministers enacted decrees permitting an expanded pilot-testing of the personified reporting systems in Moskovska Raion in Kyiv and in L'viv Oblast. Personified reporting is the first necessary step toward building a central database for the pension system in which contributions paid on behalf of, or by, all working Ukrainians are recorded and maintained. This database – similar to that maintained by the U.S. Social Security Administration – will allow closer monitoring of delinquent payers as well as the core administrative mechanism, calculating and distributing pension benefits. This personified database will also be necessary for effective regulation of any system of private pension accounts.

Ukrainian counterparts have agreed on the necessity of these two steps toward pension reform – breaking the deadlock in earlier discussions of pension reform options. At last, projections of the fiscal consequences of alternative proposals could be agreed to by all participants.

Before any pension database analogous to the database maintained by the Social Security Administration in the USA can be created in Ukraine, the State Pension Fund must invest in modern efficient computers. The State Tax Administration has already done this. The USAID/PADCO project developed a proposal under which a World Bank credit of up to \$40 million USD was made available. The credit would pay for computer equipment and software development to build a database analogous to that maintained by the US Social Security Administration. This database would move Ukraine closer to being able to man-

age the calculation and distribution of pension benefits and to eliminate the inefficient and corruption-prone system of maintaining the work history of Ukrainians in workbooks held by employers. Workbooks discourage labor mobility, create cumbersome paperwork, and are often fraudulent. Of course, these important steps toward pension reform do not solve the problems that prevented agreement on the World Bank credit in 1997 – raising pension ages and beginning to fund the state system. But by working through these steps, more and more Ukrainian decisionmakers are beginning to understand the breadth and depth of needed reforms. PADCO consultants have established a close working relationship with the World Bank. This has allowed us to discuss reasonable alternatives to the World Bank demands. For example, we have convinced the World Bank to support incentives for voluntary retirement delays as a substitute for immediate increases in the retirement age. We have also convinced the World Bank to consider a phased plan for the development and introduction of a mandatory accumulation system. Finally, PADCO staff agreed to work with the World Bank to apply the Bank's Prost pension model to Ukraine. This model has now been fully coded, and has been used to prepare 75-year projections of the current pension system, and proposed reforms to the system. This will facilitate far greater cooperation between the World Bank, PADCO, and the GOU.

The President's staff and staff within the Cabinet of Ministers have indicated, informally, that the GOU is preparing to consolidate responsibility for tax collecting under the State Tax Administration and to give full responsibility for calculating and distributing pensions to the Pension Fund. The final decrees implementing these changes had not been issued by December 1998. A pilot program in L'viv oblast, however, to transfer the responsibility for calculating benefits to the Pension Fund had been approved and work on its implementation had begun. The Cabinet of Ministers has submitted a pension reform bill to the Supreme Rada that would begin funding a portion of the state pension system – albeit not in a form that yet appears fiscally feasible. And a growing cadre of officials admits – at least in private – that the pension age will have to be raised.



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